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ABSTRACT

This report describes a provision in a tax bill implemented in June 2001 that allows towns and cities to build public school facilities faster, better, and less expensively by forming public-private partnerships with qualified real estate investors and developers. Private sector investors can fund construction, then lease the facilities to public school systems at annual costs below the costs communities would incur if they built the schools themselves. Benefits of public-private partnerships include more timely school construction, lower costs through competition, and savings through maximum use of school facilities. Communities benefit from off-hour use of school facilities (e.g., for day care services, supplemental education programs run by private organizations, adult education programs, civic events, and religious events). Because the concept of public-private partnerships for school construction and ownership is flexible, various other innovative subcontracting arrangements could be devised to help address a community's educational and service needs (e.g., using the partnership approach to acquire state-of-the-art music facilities, to upgrade cafeteria kitchens, or to improve sports facilities). The report presents experiences with such partnerships in Canada, the United Kingdom, and the United States. It describes partnership schools as alternatives to smart growth restrictions. (SM)

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NEW TAX LAW BOOSTS SCHOOL CONSTRUCTION WITH PUBLIC–PRIVATE PARTNERSHIPS

RONALD D. UTT, PH.D.

A little-known provision in the major tax bill that President Bush signed into law on June 7, 2001, will give towns and cities throughout the country the opportunity to build public school facilities faster, better, and at lower cost by forming public–private partnerships with qualified real estate investors and developers. Under this approach—pioneered in England, Scotland, and Nova Scotia, as well as in the states of Florida and Texas—public school systems can now form partnerships with private-sector investors who fund the construction of public school buildings and lease the facilities to public school systems at annual costs that are below the costs that communities would incur if they built the schools on their own.

This important reform is encouraged by the provisions of Section 422 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (H.R. 1836) that extend the privilege of using tax-exempt, *private activity* bonds to qualified public education facilities.[1] Until now, the ability to issue bonds that earn interest exempt from federal taxation was largely limited to state and local governments. This benefit provides an unfair competitive advantage for these public entities, allowing them to borrow at interest rates that are about one-third lower than the rates individuals or private companies would have to pay on their borrowing.

As a result of the privileged tax-exempt status for state and local government borrowing, the private sector was at a significant, though artificial, cost disadvantage whenever it attempted to work with communities to construct and own public infrastructure such as schools, roads, wastewater treatment plants, and airports that in turn could be leased back to the community.[2]

The new tax bill ends that competitive disadvantage regarding the construction of public school facilities by extending the tax-exempt borrowing privilege to developers who are willing to invest their funds in ways that will help to alleviate the classroom shortage in fast-growing but

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1. Section 422 is nearly identical to the Public School Construction Partnership Act (S. 526 and H.R. 2514), introduced during the 106th Congress by Senator Bob Graham (D–FL) and Representative Clay Shaw (R–FL).

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cash-strapped suburban communities or help replace and renovate obsolete and deteriorated inner-city schools in financially troubled cities.

HOW SCHOOL PARTNERSHIPS WORK

Under this new approach, a public school system can negotiate with a developer to build a public school facility in accordance with designs and standards set by the community or state. The developer can then lease the facilities to the school system under a long-term arrangement at a predetermined rent. Whereas the developer–investor would be responsible for the physical structure of the public school, the school system would still operate the school with its own teachers and administrators, curricula, educational guidelines and standards, and other such requirements pertaining to the educational process. The new law also requires that the lease term must coincide with the term of the tax-exempt bonds issued to finance the facility and that, at the end of the lease term, the physical structure must automatically become the property of the public school system.

Although the extension of tax-exempt borrowing privileges to partnerships for public schools represents an important reform that gives public school systems greater choice in financing and building their facilities, the law's statutory limits on the dollar volume of such bonds that may be issued each year will restrict its use to slightly less than $3 billion in new school construction per year. Under the new law, a state may annually issue bonds up to a total value equal to $10 multiplied by the state's population. Virginia, for example, with a population of 7 million, could issue as much as $70 million in such bonds per year—an amount sufficient to build two large suburban high schools. California could issue as much as $338 million per year. Nationwide, approximately $2.7 billion of these bonds could be sold each year to fund the construction of partnership public schools.

As a result of these volume caps, the new legislation essentially creates a national demonstration project that allows a limited number of communities to experiment with the new concept, testing its viability and versatility. Once the program's success and popularity are evident, Congress most likely will increase these caps to expand the program because this innovative approach offers a number of significant financial advantages to public school systems and also provides communities with opportunities to reach levels of quality that otherwise are beyond a typical school system's budget.

BENEFITS OF PUBLIC–PRIVATE PARTNERSHIPS

The implementation of public–private partnerships for schools in Europe, Canada, and the United States has already demonstrated significant advantages over the traditional public-sector construction approach. These advantages include the following.

More Timely School Construction. Unencumbered by the multitude of regulations that govern public-sector bond offerings, voter approval, design reviews, review of competitive bids, and construction, public schools can be built in a much shorter period of time than is possible with the traditional method. One partnership school in Florida was designed and built in less than nine months, compared to an average of five years for traditional public elementary schools built in the state.[3]

Lower Costs Through Competition. Introducing competition and the profit incentive into the process of school construction rewards expertise and efficiency. This approach will result in construction costs that generally will be much lower than those of the public-sector construction process. Recent private-sector performance in building and owning wastewater treatment plants and other infrastructure, including schools, suggests

2. Ironically, tax-exempt financing available through another federal program had been used to construct facilities for private schools. See "Panel Backs Tax Exempt Bond for School," *The Washington Post*, March 23, 2000, p. B3, and Andrea Billups, "Private School Bonds to be OK'd," *The Washington Times*, February 17, 1999, p. C3.
3. Lisa Snell, "Workplace Charter Schools: Florida Blazes the Trail," Reason Public Policy Institute *E-Brief*, May 2001, p. 1.

that savings could average from 25 percent to 30 percent of public-sector costs.[4]

Savings Through Maximum Use of School Facilities. Public school systems will experience additional savings through the partnership approach because they will be leasing a building for only a portion of the time that the facility is available for use. For the most part, a public school system uses its classroom facilities for about nine months of the year, Mondays through Fridays, from early morning to mid-afternoon. This circumstance leaves unused classroom and auditorium space available for rent in summer, on weekends, and in late afternoons and evenings during the week. Allowing the developer–investor to earn additional rent by leasing unutilized space to other qualified lessees during off-hours will result in savings that can be passed on to the public school system in the form of lower rents that are more fitting for the system's part-time use of the classroom facilities.

COMMUNITY BENEFITS FROM OFF-HOUR USE OF SCHOOL FACILITIES

Maximizing the use of school facilities is of particular importance, not only because of its potential for additional cost savings (and rent reduction), but also because of the additional benefits and convenience that a more intensively used school facility can provide for the community. All supplemental uses of a school should, of course, be compatible with those of a facility that primarily serves the interests of children and, for the most part, be contractually limited to entities that provide other educational and civic services.

One likely use would be for day-care services by private, licensed providers who would lease space from the school facility owner to provide before- and after-school care for children who attend the school. Advantages of such an arrangement would include improved safety and convenience. Once the school day is over, working parents would no longer have to worry about how to get their children safely from school to the day-care provider, because competing private providers could rent space within the building. Under such arrangements, children would have to do nothing more complicated than walk down the hall from their last class to the room where the day-care service chosen by their parents is located.

Another possible use of schools in off-hours would be for supplemental education programs offered by for-profit or not-for-profit organizations. These programs could offer instruction in subjects that are not ordinarily part of today's public school curriculum, including computer programming and technology, advanced art and music instruction, advanced sciences and math, and language classes, as well as supplemental instruction in traditional subjects such as geography and history. Additionally, after-school classes could include culture and language courses for children of ethnic minorities in the community and practical instruction such as the driver's education courses that many states require for obtaining a driver's license.

In the evenings, classroom space could be used for a variety of adult education programs offered by for-profit or not-for-profit entities. Such programs could address the academic interests and needs of local residents and could include classes on such topics as cultural enrichment, hobbies and crafts, home repair, and preparation for GED exams and standardized tests for entry into college or professional schools. Space could also be leased in the evening to local universities and community colleges that are short on classroom facilities.

Space could also be leased in off-hours for a variety of civic uses, including meetings of community-oriented clubs and organizations, political parties, boys and girls clubs, Boy Scouts, and Girl Scouts. Because the structure is privately owned, civic groups would be less likely to confront prohibitions or regulations that limit activities based on their beliefs and values, a problem that is now sometimes encountered by those who seek to use public facilities.

4. "Full Service Charter School Opens," *Public Works Financing*, July/August 1998, p. 13, and Ronald D. Utt, "Improving Government Performance Through Competitive Contracting," Heritage Foundation *Backgrounder* No. 1452, June 25, 2001, p. 8.

In accordance with community preferences, a lease agreement could be structured to allow local religious institutions to rent space after hours and on weekends to provide religious instruction that often in the past could be offered only in facilities that were owned by churches, mosques, or synagogues or were rented from private landlords. The decision to exclude religious groups from public buildings in some communities was based on concerns regarding the First Amendment and the belief that the separation of church and state precluded religious use of public facilities. Even though the U.S. Supreme Court recently ruled that such exclusions on religious grounds violate the constitutional right to freedom of speech and that public schools may not exclude after-hours religious use if other non-school civic groups are accorded that privilege, a properly structured lease agreement can further minimize the ability of opponents to accuse privately owned school facilities of First Amendment violations.[5]

Without fear of confrontation and complaint, the private owner of a school could lease space after hours to religious groups for explicitly religious purposes. This circumstance would allow children to receive religious instruction after school hours without the inconvenience and safety risks of traveling to an off-site location. Such an arrangement could allow for a variety of faith-oriented activities; for example, rabbis could offer Hebrew lessons, local priests could conduct confirmation classes, and church choirs could practice in the music room. Additionally, adult classes with similar themes and purposes could be provided at night for working parents, and classroom and auditorium space could be leased on weekends to religious groups that have not yet acquired, or cannot yet afford, their own facilities for worship.

Alternatively, depending on community standards and preferences, a school system could also require, as part of the initial lease agreement, that religious groups not be allowed to use the facilities after hours or on weekends. In either case, decisions regarding the use of a private facility would not be dictated by perceived constitutional mandates or prohibitions.

PARTNERSHIPS THROUGH SUBCONTRACTING

Because the concept of public–private partnerships for school construction and ownership is so flexible, a number of other innovative subcontracting arrangements could be devised and encouraged to help address a community's educational and service needs. This adaptability is illustrated by some of the creative developments and proposals implemented in England and Scotland in response to opportunities provided through partnerships.

In one case, a school in Waltham Forest, England, used the partnership approach to acquire a state-of-the-art music facility that it otherwise could not afford. To accomplish this aim, the school offered a private company a discount on rent and other expenses in return for building a new music room, high-tech audio/visual lab, and recording studio within the school. From Monday through Friday, during the school day, the public school students use the facility and its advanced equipment; after hours and on weekends, the use of the facility reverts to the owner–investor who leases it for commercial purposes on a for-profit basis.

In another similar innovation, 66 schools in Lewisham, England, used a partnership to upgrade and renovate their cafeteria kitchens to modern, commercial-quality level and provide school meals during a 10-year contract period. These school kitchens also will provide meals for other not-for-profit and social service programs, such as meals on wheels. Other uses could extend to meeting the food service needs of a public nursing home, a jail, a homeless shelter, and other public and/or charitable programs. As a result of this partnership, the schools received much-needed cafeteria upgrades by spreading the renovation costs among several public-service entities, while all groups benefit from a reduction in per-

5. Supreme Court of the United States, *Good News Club et al. v. Milford Central School*, Certiorari to United States Court of Appeals for the Second Circuit, No. 99–2036, argued February 28, 2001, decided June 11, 2001.

unit operating costs through more intensive and efficient use of the facility and its staff.[6]

Improved sports and recreational facilities represent another area of activity in which British schools have used partnerships with private-sector investors in a creative fashion to obtain needed upgrades. Schools in Tower Hamlets incorporated new athletic facilities as part of a school renovation project with a private partner. Similarly, Canterbury High School in Kent entered a partnership to construct a new athletic track and gymnasium, and the Collegiate High School in Blackpool signed a contract with a private business last year to provide an indoor sports center that students can use at no charge during school hours. When school is not in session, the private businesses can offer the facility for lease.[7]

If applied in the United States, this concept of "subcontracted partnerships" could be used to encourage these same kinds of educational upgrades. For example, public schools that have fallen behind in upgrading educational technology might contract with a private business to fund, build, and operate a state-of-the-art computer lab. During the day, the lab would be used exclusively by the public school students and teachers, but in the evenings and on weekends, the private business could operate it as a for-profit computer learning center, serving other residents and businesses in the community. Revenues earned in off-hour use would offset costs incurred in providing service to public school students.

EXPERIENCE IN CANADA, THE UNITED KINGDOM, AND THE UNITED STATES

Nova Scotia. One of the earliest places to adopt the partnership approach for schools was the Canadian province of Nova Scotia, which in 1997 established what it titled the "P3" (public–private partnerships) program.[8] With its economy depressed because of an historic reliance on declining natural-resource-based economic activities, the province lacked the public revenues needed to build the first-class public schools that it believed were the key to its future prosperity. With limited public funds, and with taxes already too high, Nova Scotia created an ambitious and comprehensive program to encourage private-sector investors to build new school facilities that would be leased on a long-term basis to the province's public school system.

During the few years the program was in operation—a change in government, from liberal to conservative, led to its termination—33 new partnership schools were approved for construction, and 22 of these were available for use at the beginning of the 2000–2001 school year.[9]

United Kingdom. At about the same time that Nova Scotia adopted its P3 program, the United Kingdom's Secretary of State for Education and Employment announced a major commitment to improve the British system of "state schools."[10] Better school facilities are a major component of this effort, and according to the Secretary, "Public Private Partnerships will be key in achieving these new or improved facilities."[11] Between 2000 and 2004, the department intends to commit nearly

6. "Public Private Partnership (PPP) Projects in Schools: Project List," Department for Education and Employment, United Kingdom, September 1998.
7. "Public Private Partnership (PPP) Projects in Schools: Project List," Department for Education and Employment, United Kingdom, May 2001.
8. "Building Education: Nova Scotia's Smart New Schools," brochure published by Nova Scotia Department of Education and Culture, undated.
9. See Ronald D. Utt, "How Public–Private Partnerships Can Facilitate Public School Construction," Heritage Foundation *Backgrounder* No. 1257, February 25, 1999, pp. 4–6; see also "Nova Scotia Schools Fail Lease Test, *Public Works Finance*, November 1999, p. 32, and "Nova Scotia P3 Schools Botched," *Public Works Financing*, July/August 2000, p. 32.
10. In the United Kingdom, the term "state school" is used the same as "public school" is used in the United States. Conversely, the term "public school" refers to what people in the United States call a private school.

$12 billion to school facilities. Included in this total is an estimated $3.9 billion devoted to school construction and renovation under the Private Finance Initiative (PFI) component of the Public Private Partnerships program.

The first project to be completed was a new primary school in Kingston Upon Hull, and this success was soon followed by partnership agreements with state schools in Dorset County, Enfield, Hillingdon, Dudley, and Portsmouth, as well as with a parochial school in Leeds. Shortly thereafter, major partnership contracts were signed for school replacement and renovation in Edinburgh and Glasgow, Scotland.[12]

Initial successes, combined with continued investor and school system interest, led to a growing number of school projects that are now underway, under contract, or in serious planning stages. In early 2001, major contracts totaling $260 million were signed with three separate investor–developer–builder groups to construct or renovate 32 schools in three different regions of England. Locations included Huddersfield in the Yorkshire area, the Wirral (northwest England), and London.[13]

United States. Until now, the availability of significant tax preferences for school facilities owned and operated exclusively by public school systems has had the effect of putting partnerships with private-sector partners at a costly disadvantage in most American communities. However, despite such obstacles, creative developers and school systems have been able to use what flexibility the law permits to cobble together a number of innovative partnership hybrids. These partnerships have allowed several American communities to build their schools faster and for less money than would have been possible under the traditional public-sector approach to school construction.

One of the first partnership schools in the United States was a public charter school built in **Pembroke Pines, Florida,** by the forerunner company of Chancellor Academies of Coconut Grove. A primary school was the first to be completed, and it opened in September 1998. Construction costs were between 22 percent and 34 percent lower than those of the public primary schools built in Florida during the same period. Despite a requirement that all parents do volunteer work at the school, enrollment was oversubscribed and a waiting list had to be implemented.[14] Parent interest has remained high, and since the September 1998 opening of the initial elementary school, the partnership has added two pre-schools, a second elementary school, a middle school, and a high school (all public charter schools) that now serve approximately 3,000 students. As of mid-2001, Chancellor Academies had been involved in the establishment of 14 additional charter schools in Florida, Arizona, and the District of Columbia.[15]

In 1998, the **Houston, Texas,** Independent School District, headed by Roderick R. Paige (now President Bush's Secretary of Education), formed a partnership with Gilbane Properties of Providence, Rhode Island, to construct two new high schools under a lease-purchase arrangement. The high schools, each with about 500,000 square feet of space, now accommodate a total of 6,000 students and have helped alleviate classroom crowding in a fast-growing school district in a public school system that attracts 4,000 to 5,000 new students each year.[16]

Gilbane reports that the schools were completed a year earlier than would have occurred with the traditional public-sector procurement approach,

11. "Public Private Partnerships (PPP): A Guide for School Governors," prepared by the Department for Education and Employment, United Kingdom, and available at *www.dfee.gov.uk/ppp/intro.htm*.
12. *Ibid.*, esp. "A Guide for School Governors: Questions relevant to all schools," at *www.dfee.gov.uk/ppp/contents.htm*.
13. "UK Signs More School Concessions," *Public Works Financing*, April 2001, p. 22.
14. See Utt, "How Public–Private Partnerships Can Facilitate Public School Construction," p. 9.
15. Details of Chancellor programs and activities are available at *www.chancelloracademies.com*.
16. "Customer Focus," A Gilbane Properties Inc. Publication, Vol. III.

and at a total project cost that was $20 million below the school district's original estimate.[17]

In February 2000, officials of the **Los Angeles, California,** Unified School District proposed the creation of a pilot program to test a new partial-partnership privatization approach to speed up the school construction process by turning over the financing and construction of primary schools to private developers. The pilot program was proposed in response to a series of delays in attempting to meet the district's goal of opening 20 new primary schools through the traditional public-sector approach. Under the proposal, developers would finance the construction with bank loans, build the school, and then sell the completed schools to the school district. Proponents of the plan believe that it would be cheaper and faster than the current process.[18] The plan has not yet been implemented.

Elsewhere, many school districts are establishing *de facto* partnerships as they turn to existing vacant, privately owned commercial space as a way to get needed classrooms quickly. Empty warehouses, stores, and car dealerships are just a few of the privately owned structures that several school systems have leased or acquired to accommodate exploding enrollments.

- In **Mesa, Arizona,** 700 elementary school students began class in August 2000 in a former Smith's grocery store, renamed the Pedro Guerrero Elementary School.
- In **Raleigh, North Carolina,** 1,200 middle school students use a converted manufacturing facility for classes.
- Two magnet schools in **Patterson, New Jersey,** leased unused space from an empty downtown mall.
- In **Phoenix, Arizona,** the Cartwright Elementary School took over a 300,000-square-foot area of what had once been known as the Maryvale Mall and shared the space with students from the Marc T. Atkinson School.[19]

Another innovative school facilities privatization trend is the "company school." This term applies to the growing number of cases where a major employer in a community provides classroom space to the local public school system in order to accommodate the children of employees as well as any other students in the system if the law requires, or as appropriate. In **Miami, Florida,** Ryder Systems opened its first satellite charter school adjacent to its headquarters. Initially serving 300 students in kindergarten through third grade when it opened in 1999, the Ryder charter school has since added a fourth and fifth grade and now has an enrollment of 500 students, including the children of its employees as well as children living in the surrounding community.[20]

Several other similar projects have also been undertaken in a number of **Florida** communities.

- A 12,000-acre retirement community called The Villages built a charter public school for students in kindergarten through fifth grade that serves 347 children of The Villages' employees. Future plans include a middle school and a high school.[21]
- NationsBank provided elementary school space for 176 children in **Jacksonville**, while the **Orlando** Regional Healthcare System set up a school to serve 60 children of its employees in kindergarten through second grade.[22]
- The **Miami** International Airport has established a kindergarten-through-second grade school for its employees' children.

17. "Point of View: The Public/Private Partnership Concept: An Alternative for School Facility Delivery," presented by Gilbane, 1999, p. 5.
18. Doug Smith, "Privatization of School Construction to Be Tested," *The Los Angeles Times*, February 12, 2000, p. B5.
19. Haya El Nasser, "Schools Forced to Roam in Search of More Room," *USA Today*, August 18, 2000, p. A3.
20. Richard Seder, *Satellite Charter Schools: Addressing the School-Facilities Crunch Through Public–Private Partnerships*, Reason Public Policy Institute, April 9, 1999, and Snell, "Workplace Charter Schools," p. 1.
21. Snell, "Workplace Charter Schools," p. 6.

These company schools not only save the community the cost of the structure, but also provide added convenience for working parents and can easily be combined with workplace day-care programs.

PARTNERSHIP SCHOOLS AS ALTERNATIVES TO "SMART GROWTH" RESTRICTIONS

Now that federal legislation favorable to the creation of partnership schools has been passed, public schools that are privately constructed and owned could get a boost from the escalating concern in many communities regarding higher costs that rapid population growth can impose on local taxpayers. New homes mean new families, and new families mean more children for the school system. In the fast-growing ex-urbs of many metropolitan areas, the increase in students has led to crowded schools because school systems have failed to sustain construction projects to match the growth in enrollment. Worried about the costs that such enrollment growth may impose on local taxpayers, many communities are looking for ways to limit growth or to impose "impact" fees on builders and new homebuyers.

While restrictions, limits, and fees are often the typical responses to suburban growth concerns, a number of communities have welcomed innovative partnerships that have allowed for growth while keeping public infrastructure costs in check.

- In **California**, a new state law allows homebuilders to provide the community with a school in lieu of the impact fees that would otherwise be charged for each new home built. One of the first towns to take advantage of the law was **Corona**, which in December 2000 was provided a new elementary school by a developer who was adding 1,200 new homes in the community.[23]
- A similar exchange occurred in the suburbs of **Denver, Colorado**, where homebuilders have agreed to build new public schools in the new subdivisions they construct in return for permission to build additional houses in the community.
- **Florida** is considering a law similar to California's that will allow builders to provide new schools in lieu of impact fees or in exchange for permits and/or zoning approval.

With the new availability of private activity bonds for schools, such infrastructure obligations will be easier and less expensive for developers to fulfill, and more and more builders, or consortia thereof, will be inclined to enter the school facilities business. In turn, this development will lead to better, less expensive school buildings and allow the school system to concentrate its energies where it can make the most difference—educating children.

CONCLUSION

Fast-growing suburbs, deteriorating cities, and a demographic "echo boom" of school-aged children have left many communities struggling to provide adequate classroom space. Although there are many reasons why some communities have fallen behind, a common cause of the delays and shortfalls is the cumbersome public-sector construction process through which it can take as long as five years to fund and build a public school, while the same project could be accomplished in the private sector within a year. Provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 will address that problem for some school districts by allowing a limited number of communities to transfer the responsibilities of financing, building, and owning public schools to private-sector investors who will lease schools to communities.

As has been demonstrated in Canada, the United Kingdom, and the United States, public–private partnerships that utilize the talents and resources of private entrepreneurs offer the prospect of building less expensive, higher quality

22. "Private Activity Bond School Construction," material prepared by office of Senator Bob Graham (D–FL), October 10, 1998.

23. *Privatization 2001: The Fifteenth Annual Report on Privatization*, Reason Public Policy Institute, 2001, p. 25.

schools in shorter periods of time than is currently possible through traditional public-sector management and funding. Under the conventional school construction process, the public school system attempts to be both educator and real estate developer, and sometimes performs both functions inadequately as limited resources and specialized talents are spread thinly among disparate endeavors.

Through partnerships, America's school systems can focus strictly on education while for-profit developers apply their expertise in the construction of the facilities. When implemented to its fullest, such a system of partnerships could yield both better buildings and a better education for our nation's youth.

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